



11 o'clock files

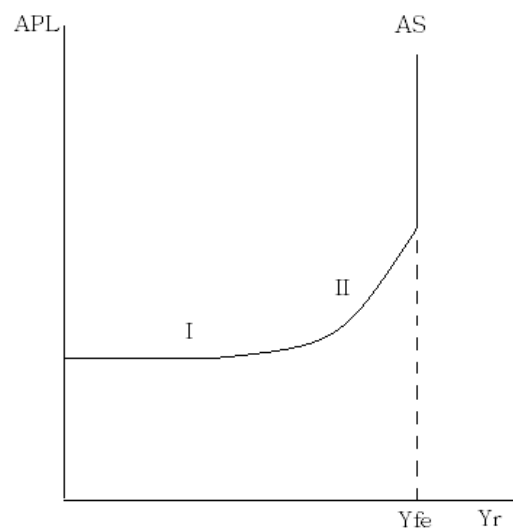
Simply AS à la Keynesian School

Aggregate Supply

- The AS shows the *planned* level of domestic output domestic firms are willing to offer at different average price levels per period

Keynesian School

- They do *not* distinguish between the short run and the long run
- They assume that money wages are *sticky downwards*
- The Keynesian AS has 3 sections:
- Section I (horizontal); section II (upward sloping); section III (vertical at Y_{fe})



- Section I refers to economies in deep recession meaning that the level of real output is way below the full employment level → thus, it is horizontal → if AD increases from AD1 to AD2, real output can increase without any increase in the APL as unemployment is very high and there is ample spare capacity
- Section II is upward sloping because after a point, ‘bottlenecks’ start to appear in labor and resource markets → given that labor is not homogeneous, an increase in AD will lead to both higher prices and higher levels of real output:

Industries/sectors with plentiful spare capacity will be able to produce more output but industries/ sectors where spare capacity has been exhausted will witness rising prices: as AD rise from AD3 to AD4 both real output *and* the Average Price Level increase.

- The closer to full employment the economy is operating, the greater the effect on prices of a further increase in AD and the smaller any gain in real output
- Section III is vertical, as if full employment in an economy has been reached within the Keynesian framework, any further increase in AD will only prove inflationary: an increase in AD from AD5 to AD6 will only prove inflationary

